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Understanding Mercosur and its Future

-Félix Peña



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Miami European Union Center
University of Miami
1000 Memorial Drive
101 Ferré Building
Coral Gables, FL 33124-2231
Phone: 305-284-3266
Fax: (305) 284 4406
E-Mail: jroy@miami.edu
Web: www.miami.edu/eucenter

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Félix Peña*

**The Jean Monnet Chair
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* Félix Peña has a law degree from the Universidad Nacional del Litoral in Santa Fe, a law doctorate from the University of Madrid, and a degree in European law from the Universidad Católica de Lovaina. He has worked in INTAL, in the Ministry of Foreign Affairs and the Ministry of Economy where he was Under-Secretary of Trade. In the Ministry of Foreign Affairs he participated in the creation of MERCOSUR as the Argentine coordinator in the negotiations for the Treaty of Asunción. Dr. Peña is Director of the Instituto de Comercio Internacional-Fundación BankBoston; Professor at the Universidad Nacional Tres de Febrero, and a member of CARI's executive board. His most recent book is *Momentos y perspectivas: la Argentina en el mundo y en la región*. Buenos Aires: Eduntref, 2003.

Understanding Mercosur and its Future

Introduction

Four Main Approaches to Understand Mercosur

After almost fifteen years of its formal creation by the Asunción Treaty, it is possible to draw some lessons of the Mercosur experience and to introduce some reflections concerning its future. Mercosur is a term that is used in relation with a *regional reality*, a *strategic idea*, a *formal economic integration process*, and an *image*.

As a **regional reality**, Mercosur is multidimensional. It constitutes an international subsystem that results in interactions at the political, economic and cultural levels. It expresses itself through perceptions and behaviors of governments, firms and civil society organizations, and through trade and investment flows; as well as a network of interactions involving several aspects of social life. It covers a great part of South America. In its hard core, the Southern Cone of this region, there is a shared history that includes conflicts, rooted deep in history back to the Iberian Peninsula.¹

As a **strategic idea**, Mercosur implies an option for the logic of integration in the relationship among its member countries. It implies the building of a common ground of political stability and democracy within the region, mainly through economic preferences and common policies, with the idea of competing and negotiating together at the global level. It is not an abstract idea. It reflects concrete and dynamic national interests that are not always exactly the same for each of the member countries, due among other factors, to the significant differences of economic dimensions among them.

At the founding moment of the bilateral economic integration and cooperation program among Argentina and Brazil, in 1986, the strategic idea was closely related to the need to consolidate the “new born” democratic processes. Later on, other goals appeared, linked to the member countries’ needs in the field of economic modernization and international trade negotiations, especially at the hemispheric level – after the launching in 1991 by President Bush of the American Enterprise Initiative. The main idea was to enlarge, through economic preferences the national markets, so firms could invest and transform them to become more competitive both at the regional and global level, and to build a more attractive environment for both domestic and foreign investments. The assumption was that these would generate a win-win situation for the four member countries, including those with small economies, as were the cases of Paraguay and Uruguay.

¹ Helio Jaguaribe, “Brasil-Argentina: Relações de conflito e cooperação,” in *Revista Brasileira de Política Internacional*, 93-96 (1981): 131; Rosendo Fraga, “Evolución histórica de los países del Mercosur,” in *Mercosur: un atlas cultural, social y económico* (Buenos Aires: Ediciones Manrique Zago e Instituto Herbert Levy, 1996), 91; and Alberto Methol Ferré, “Mercosur, América del Sur y América Latina,” in *idem*, 119.

The idea of integration was then the result of concrete national interests. Not the result of any hypothetical supranational rationality. As well as in Europe, the idea of a regional approach to economic development started at the national level and not the other way round.²

If we go down to its deepest cultural roots, we can find the need to reaffirm the national identity in face of the challenges of globalization. This was the main idea behind the option for a strategy of working together among sovereign nations on a systematic and permanent basis. This strategic idea does not necessarily produce an irreversible phenomenon. Should this occur, we will only know it with the passing of time. But its distinctive characteristic, what turns it into a phenomenon different from a traditional friendly relationship among neighboring nations, is that it has an implied ambition to be irreversible. This is the reason why the pact that formalizes the strategy – in this case the Treaty of Asunción - is of a permanent nature. It does not generate a lineal process. On the contrary, as the European experience shows us, it implies a very winding road, which will even suffer crises and eventual setbacks.

As a **formal economic integration process**, Mercosur means a consensual alliance among sovereign nations, through the development of common mechanisms and rules that allow them to share markets and resources, beginning with a customs union that should become then a common market.

Common principles, criteria and rules of the game – both formal and informal - are conceived as a set of signals sent to citizens, investors and third countries, regarding the desired long term goals of the partners and the road map to achieve them.

These are not, nor could they be, instruments or rules of the game that apply only to short-term trade. For that restricted purpose, it was not necessary to design such a complex and ambitious project as Mercosur. On the contrary, its legitimacy lies in the long term objective, which was explicitly defined for the association: the development of a common market, as it is defined in the Treaty, and built upon the reciprocity of rights and duties among the partners. This is why its results cannot be measured only in terms of global and sector short term trade balances. These instruments and rules of the game have - at least they should have – a real influence upon the investment and strategic decisions of both domestic and foreign firms. The quality and efficiency of these instruments and rules will largely depend on the degree of predictability they offer to investors. Therefore, their deepest results should be measured in terms of its impact on investments generated in each member country as a result of the preferential access to the markets of their partners. The rule oriented nature of the integration process –if it is really achieved – is, therefore, crucial for its success and social legitimacy.

² As regards national interest in the origins of European integration, see Alana Milward, *The European Rescue of the Nation-State* (Los Angeles and Berkeley: University of California Press, 1992); “Memorandum of Jean Monnet,” May 3, 1950, in *Le Monde*, May 9, 1970. This subject was analyzed by Félix Peña, “Previsibilidad y eficacia: la integración voluntaria entre naciones soberanas,” in *Encrucijadas*, Revista de la Universidad de Buenos Aires (February, 2001), 48.

In terms of **image**, Mercosur is the result of the perception held by citizens, investors, and third countries, in the sense that its formal goals, mechanisms and rules of the game, are really credible because they will be enforced. It implies that they could have a real influence in expectations and behaviors of the main protagonists of the economic life at each of the member countries. The weaker, more inaccurate and volatile the signals – or the lower their quality – the poorer will be their impact. In that case, the level of efficiency - for example, the expected outcome in terms of investment decisions oriented toward the enlarged market - will be negatively affected.

Thus, the image cannot be the result only of rhetoric and idealistic approaches. As long as the image is sustained in the real life, it will certainly be an important element in the concrete behavior of economic and social actors. But the expert eye, that of the investor and third countries with whom Mercosur intends to negotiate, will assess the quality of the commitments undertaken by governments, their strength, enforceability, and potential to penetrate reality; as well as their projection and permanence over time. If there is no correlation among the instruments (for example, the unrestricted opening of markets and macroeconomic coordination) and if there is no satisfactory answer to basic questions regarding the conditions to operate within the enlarged markets, the possibilities of attaining a customs union and then a common market will remain uncertain and the investors will become more doubtful about the decisions they have to make. In that case, the credibility gap will also affect the idea of strengthening the capacity of the group to negotiate with third countries.

After Almost Fifteen Years of Mercosur Experience: A Balance of Achievements and Failures

What is the balance we can draw from the Mercosur experience? We could consider it in relation with each of the above mentioned dimensions.

As a **regional reality**, Mercosur presents a significant progress in the quality of the relations among a group of neighbor's countries. This is evidenced by the growth in trade and investments within the integrated area, especially in the 1991-1998 period. It is difficult to assess how much of this progress is due to Mercosur's formal integration process and instruments, and how much to the geographical contiguity of countries that have significantly opened up to international trade. It is also difficult to know what may have happened with trade and investments among its members if Mercosur as a process had not been a reality.

However, it is certain that we have passed from a low level of relative interdependence – measured by different trade and direct investment indicators, as well as those that show the willingness of a joint defense of democracy (as was the case during a political crisis in Paraguay) – to a higher interdependence level. On account of this situation it is difficult that what happens in one country does not have a strong effect on the political and economic life of the others. Mercosur have not yet attained the level of economic interdependence, much less political, that the European countries had in 1950,

when they created the European Community of Coal and Steel through the Treaty of Paris, or when in 1958, they started the process of what is today the European Union. It has not even attained the level of economic interdependence existing in North America, when in 1994, the NAFTA was formalized.

At present, in Mercosur, both the politicians and the citizens have the feeling of “being on the same boat.” This feeling is shared by those who have invested or placed their savings in the region. It is reflected in the contagion effect which means that what happens to the economy of one partner will be felt in the economies of the others. This is especially true if the country that suffers a problem is one of the major partners. In terms of country risk, the markets are already integrated, in spite of the attempts to focus on differences during critical situations.

It is not easy to imagine a setback in this dimension, for example a return to a low level of interdependence. What may occur, however, are variations in the levels of regional interdependence. The experience of the Mercosur and South American region and specially the experience of other international subsystems such as those in Europe and the Middle East, indicates that a growing interdependence among a group of countries that share a geographical area may have a predominantly conflicting character or a predominantly cooperative one. The economic and political value of moving from a predominantly conflicting interdependence to a predominantly cooperative one is very high, as evidenced by the European experience of the last fifty years compared to the last few centuries. This is not something that may be measured, for example, in terms of trade flows or of development of common infrastructure projects.

As a **strategic idea**, we can see greater continuity and consistency in the political leadership over the last twenty years in the Mercosur region. Perhaps this is the main contribution from the so called presidential diplomacy, leading to the creation of Mercosur as an area of integration and solidarity among its members. This was evidenced at the founding moment in 1986, and then again in 1990. But this has particularly been observed during periods of crisis, for example, the car industry crisis in 1995, the 1998-1999 economic recession period, and even more recently when Argentina adopted exceptional economic measures after its crisis of 2002.

A detailed examination of those events clearly shows that in all cases the political leadership has favored the preservation of the strategic direction of the integration process. Two presidential leadership abilities appear to be outstanding: the assessment of each situation within a long term vision and in the larger framework of converging national interests, and the recognition that the most valuable element for the common project is the economic and political health of each partner (democracy, and economic growth and stability). This has led the political leaders to act in accordance with a strict sense of prudence when one of the partners is experiencing serious difficulties, accepting sometimes *de-facto* flexibility with respect to the implementation of the formal commitments and the time-table of the economic integration process.

But it is also in this dimension of the strategic idea, where one may observe different perceptions from the member countries with respect to the real situation and the behavior of other partners. On occasion, the perception of eventual disloyal conduct by the government of one member country or controversial assessments of the real distribution of costs and benefits of the integration process, have contributed to weakening the feeling that the strategic idea is shared with the same intensity by the different partners. Reflected by the media to each country's public opinion, often in the middle of a crisis, this stimulates the culture of conflict rather than the culture of cooperation. Here lies one of the issues that will require a great deal of attention in the future, if the member countries desire to deepen integration in Mercosur and to increase its social legitimacy in each of them.

However, the fact that the political leaders have been normally strongly determined to support the strategic idea does not necessarily imply that each country economic policy is always consistent with Mercosur commitments. On the contrary, the growing loss of relevance of the previously frequent meetings of Economy Ministers and Central Bank Presidents, might be evidence of a significant gap between the specific economic policies of each partner and the strategy to build Mercosur. Except for the initial period during which the biannual meetings of Economy Ministers and Central Bank Presidents became a real driving force of the integration process, the Ministers appeared aloof, and eventually, not very interested in being directly involved in the Mercosur development. Sometimes they have only done this during crises. This may even account for the lack of progress in coordinating macroeconomic policies, especially since the 1994 Mercosur Summit at Ouro Preto. It may also account for the growing deterioration of Mercosur as a formal economic integration process.

As a **formal economic integration process**, perhaps is where it is possible to observe that progress in building Mercosur has been even more limited. In the beginning, it seemed feasible to advance rapidly, but after the initial transition period -1991-1994- a relative ineffectiveness and inefficiency has characterized the evolution of the economic integration process. This was also the case during the bilateral integration program among Argentina and Brazil, in which it was possible to observe that after a significant progress in the first two years -1986-1988, it then stagnated largely due to the political and economic performance of the two countries.

The period initiated in 1991 with the Treaty of Asunción received a strong boost, partly because of an international and local environment favorable to these types of initiatives, and partly as a result of the automatic nature of the trade liberalization process, taking place not only between Argentina and Brazil but also extended to Paraguay and Uruguay.

Thus, we arrive at the most recent period –the roots of which may be found in Mercosur decisions adopted and even those not adopted at Ouro Preto in December 1994 (for example, regarding non-tariff barriers and safeguards), and the lack of progress in macroeconomic coordination. During this stage we observe significant institutional deficiencies, low quality rules of the game, and a growing weakness of the economic

preference and of collective disciplines, for example in the field of export and investment incentives.

As an **image**, Mercosur has experienced in recent years, both at the national level of each member country and abroad, a deterioration of its credibility. It reflects the perception by public opinion, investors and third countries, of a weakening of the quality of the economic integration process. In 1995, the good image reached a peak when the nations overcame the effects of the Tequila crisis. In the period from 1998-1999 (particularly during the first semester of 1999), Mercosur's image began to deteriorate after the Brazilian devaluation of the Real. The situation deteriorated more when Argentina had its own 2002-2003 deep economic and even political crises.

In each of the member countries, Mercosur began to be perceived –with some exaggeration- as part of the problems and not necessarily of the solutions. The conflicts and crises multiplied. Gradually, the image of a stagnated process settled in. A vicious circle emerged, consisting of low effectiveness of the rules of the game (they do not correspond to reality), reduced efficiency (the expected results are not achieved), loss of credibility (citizens, investors and third countries have started to doubt if the process is feasible), and the loss of attractiveness.

In the Mercosur of this last period, we may also observe the introduction of the social illegitimacy virus. The public opinion of member countries start to doubt if the association is based on a win-win relationship and hence, if it is convenient to continue with its development as it is today. The original strategic idea does not seem to be questioned. Yet, people do debate the methodologies of the economic integration process. Expressions, such as “Mercosur has died” or “Mercosur is useless if it remains as it is,” may seem exaggerated but have become more frequent.

We can conclude that almost fifteen years after its founding moment, Mercosur as a *regional reality* and as a *strategic idea*, maintains its relative strength. However, there is a growing concern with respect to its real capacity as an instrument to negotiate together with third countries and its efficiency to stimulate development and investments in all the member countries. This is because, as an *economic integration process* and as an *image*, Mercosur exhibits remarkable deficiencies. However, there has been a learning effect in the sense of knowing how to advance –or not to advance- in an integration process of these characteristics.

A strong political decision will be needed to overcome the relative deterioration of the economic integration process and of the Mercosur image. This would be especially necessary, if member countries want to adapt it to the challenges of the new international economic and even domestic realities. It is in this sense that the accumulated experience should be capitalized, in order to prevent the deterioration of the process and its instruments from contaminating the quality of the achieved regional interdependence, which will continue to grow at any rate.

Three central questions with respect to the accumulated experience

Three central questions arise when reviewing the first fifteen year experience of Mercosur:

- What lessons can be drawn in terms of the methodology of consensual integration among sovereign neighbor nations?
- What scenarios can be drawn with respect to the future of Mercosur considering, in particular, the FTAA negotiations and those with the European Union? and
- What issues would be crucial for Mercosur's future as a regional process that could be functional to each member country's national objectives, particularly those related with the consolidation of democracy and the modernization of their economic and social life?

Lessons concerning integration methodologies

With respect to the *first question*, we should pay particular attention to three essential aspects of integration methodologies.³ It is on these issues that the protagonists –both at governmental and business level- and analysts should focus their reflections.

The first one is related with *efficiency*, in terms of how to achieve the original goals of the economic integration process, particularly in terms of building a common platform from where to compete and negotiate at the global level. This issue is related to the redefinition of some of Mercosur instruments and rules of the game in order to enhance its potential effectiveness. It is directly linked to the question of how to develop a dynamic reciprocity of national interests at stake, so that the instruments and rules of the game could produce a win-win relationship and are not perceived by any member country as originating a zero-sum game.

The second question is that of *credibility*, in terms of the perception of investors about how seriously they can consider Mercosur commitments when adopting investment and strategic business decisions, and of third countries –for example the United States and the European Union- when considering it as a valid interlocutor in international relations and negotiations. The collective memory as regards the Latin-American tradition of the “fiction-integration” influences the way citizens, investors and third countries perceive Mercosur when they have to assess its commitments, making them

³ Félix Peña, “Reglas de juego, instituciones e integración económica: reflexiones desde el Mercosur,” in *Archivos del Presente* (Buenos Aires, October-November-December 2000), 97.

highly sensitive to any indicator that the member countries are not really willing to attain their agreed goals. Therefore, credibility will strongly depend on the efficiency and effectiveness of the instruments and rules of the game.

The third question is that of *social legitimacy*. It focuses on the public opinion's perception of Mercosur's contribution in terms of taking care of public needs, expectations and interests, related with resolving critical problems of the political, economic, and social agendas. Social legitimacy also is related to the perception of how effective the distribution of costs and benefits of the integration process is among the partners, taking into account the existing sharp economic differences. This leads to questions about Mercosur's opportunity costs compared to other economic integration alternatives. In practice, this issue underlies the debate that from time to time is possible to observe in some member countries, between Mercosur as an integration process and the FTAA or other imaginable options for a special and preferential relationship with the United States. The permanence, efficiency and effectiveness of the economic integration process and the rules of the game will ultimately depend on their social legitimacy.

The accumulated experience is pointing out the political need to carefully approach the issues of efficiency, credibility and legitimacy, in any process of consensual integration among sovereign nations. This may not be achieved without introducing mechanisms that will allow for an effective preservation of national interests in the implementation of the integration process.

About some possible future scenarios for Mercosur

With respect to the *second question* we can see at least three trends for Mercosur's future scenarios. It is even possible to imagine combinations of the different scenarios.

a) Irrelevance

The first one – possible and somewhat likely- is the trend toward a continuous deterioration of the integration process and of its image, gradually slipping into a growing irrelevance as regards the agenda of critical issues for all or some of the member countries. This would be the scenario which we would call the “aladification” of Mercosur: it continues to exist as a process but its commitments are diluted and lose effectiveness in the perspective of citizens, investors and third countries. It does not influence significantly any longer on its expectations and behaviors. In this scenario, Mercosur would continue to exist as a formal process, but it would lag behind – with so many other experiences of Latin American integration-, in a kind of museum of “the irrelevant”⁴. Nobody else would care about it. This scenario may be dysfunctional as

⁴ Félix Peña, “Reglas de juego e instituciones en el Mercosur,” *Revista de Derecho Privado y Comunitario*, num. 14, (Santa Fé 1997), 395.

regards the goals of a cooperative interdependence, not only in the current Mercosur area but also at the South American region. This would end up eroding the original strategic idea.

b) Dilution

The second one – possible and also relatively likely- is the trend toward the dilution of Mercosur into an eventual integration at the hemispheric level with the FTAA. This scenario may co-exist with the former one. It may lead to a changed Mercosur – as a matter of fact or of law – in a kind of free trade area. The external common tariff would be diluted, mainly in its principal element (for example the collective disciplines in the field of trade policy). Each country would then enter individually into a large hemisphere-wide free trade area. Mercosur as an economic region would survive but the integration process and its instruments would be overcome by those adopted at the hemisphere level. This scenario, in turn, may result from the current negotiations of the FTAA or its transformation into a network of free trade agreements, in which the United States would be the trade hub. Mercosur's current partner countries may eventually negotiate free trade agreements with the European Union, as did Mexico and Chile. Its effects on the future of South American interdependence are difficult to forecast. Eventually, they may be similar to the irrelevance scenario. This might also erode the original strategic idea.

c) Consolidation

The third one – possible and still likely- is the trend toward the renewal and consolidation of the Mercosur integration process and its instruments, as a regional and institutionalized subsystem, with a growing South American dimension. This is the preferred scenario of actual governments. This would be the scenario of a “serious” Mercosur, with economic preferences, collective disciplines and rules of the game that are actually enforced and that contemplate the interests of all the member countries. In this case, Mercosur as an integration process, would imply higher commitments than those undertaken in the FTAA. It would also maintain the possibility for free trade agreement negotiations with the European Union. It would strongly contribute to the social legitimacy of the hemisphere and transatlantic trade negotiations.

This is the scenario that was originally imagined for Mercosur and, in my opinion, continues to be the favored scenario, consistent with each partner's national interest. It is also the scenario that would contribute most greatly to the development of political stability and democracy in South America.

The future development of Mercosur

As regards the *third question*, there are priority issues that should be addressed on the agenda for the renewal and consolidation of Mercosur as an integration process. Four are more relevant. The first one is related with its institutional quality, particularly its

normative production process and the enforcement of its rules. The second one refers to strengthening the main collective trade disciplines and the development of a gradual coordination of macro-economic policies. The third one is related to the extension of the economic preference among member countries, covering not only trade on goods but also services and government procurement. And finally the last one is related to the need of developing concrete measures of cooperation with the smaller countries, to allow them to take advantage of the enlargement of their markets through an effective access to those of Argentina and Brazil.

Some conclusions

We may conclude by affirming that, under the original strategic idea, none of the problems existing in the Mercosur -as a formal integration process- are without reasonable solutions. This remains true as long as there is a willingness to negotiate, to really create a common market and to preserve the reciprocity of national interests that is the only way that the association can maintain its social legitimacy.

To achieve the original strategic idea, however, it would require a strong collective political leadership, technical imagination, and the creative participation of the civil society.

A consolidated Mercosur is not contradictory to the idea of the FTAA. On the contrary, it may be a necessary condition for successful negotiations on the hemisphere level and, above all, for its social legitimacy in the member countries. Without Mercosur, the idea of free trade in the hemisphere would be more easily exposed to strong social criticisms. A consolidated Mercosur is also the best way –perhaps the only one- to achieve the goal of a bi-regional strategic association with the European Union.